



**Semiannual Report
of the Inspector General
U.S. Small Business Administration**



Spring 2002

A Report to Congress

October 1, 2001 – March 31, 2002

Pursuant to Public Law 95-452

Foreword

I am pleased to submit our Semiannual Report on the Office of Inspector General's (OIG) activities from October 1, 2001, to March 31, 2002.

This has again been a productive period. Looking at the standard productivity measures for OIG activities, we see that the Office issued 16 reports on efficiency and effectiveness activities, primarily based on OIG audit and inspection activities. OIG investigations resulted in 21 indictments and 29 convictions for criminal violations. The Office brought its collective experience to bear in reviewing 116 legislative, regulatory, policy, and procedural proposals concerning SBA and Government-wide programs. Overall, OIG dollar accomplishments from all activities totaled more than \$41 million. All of this was accomplished with an appropriation of \$11.9 million and an average staff level of 107. I am truly proud of the accomplishments of OIG's dedicated and professional staff.

We continued to focus our efforts on several key areas identified in our current strategic plan: financial management, information systems and computer security, lender oversight, high-risk issues, and new SBA initiatives. Discussion of our efforts in these areas can be found in the body of the report. Perhaps the most significant report we issued during this period was our updated assessment of the 10 most significant management challenges facing SBA. The challenges we identify are virtually identical to those contained in last year's list and cover a broad range of SBA activities – from strategic planning and financial management to program specific issues such as lender oversight and the Section 8(a) business development program. While progress has been made towards addressing these issues, more can be done. We in OIG will continue to look for ways to work with Agency managers to add value to this process and to identify potential solutions.

Looking towards the future, OIG has been engaged in reviewing our strategic direction and rearticulating our plans and goals in light of our rapidly changing environment. We seek to maximize our relevance and value to SBA and the Congress by ensuring that we direct our resources to the most critical priorities. To that end, we are nearing completion of a year-long effort to revise our strategic plan. We will emphasize prevention and deterrence, early identification of risks and management challenges, and a more integrated approach within and across our audit, investigation, and evaluation functions. I am excited by this approach and look forward to sharing this in more detail with our stakeholders and customers over the coming months.

Finally, I would like to express my deep appreciation for the ongoing support and interest of Administrator Barreto and the Agency's senior staff. Without their willingness to assist us and take action on our recommendations, we would not be effective. We look forward to continuing our partnership with SBA's leaders so that we can make a positive difference in the way Agency programs are being delivered to our customers, the small business men and women of America.

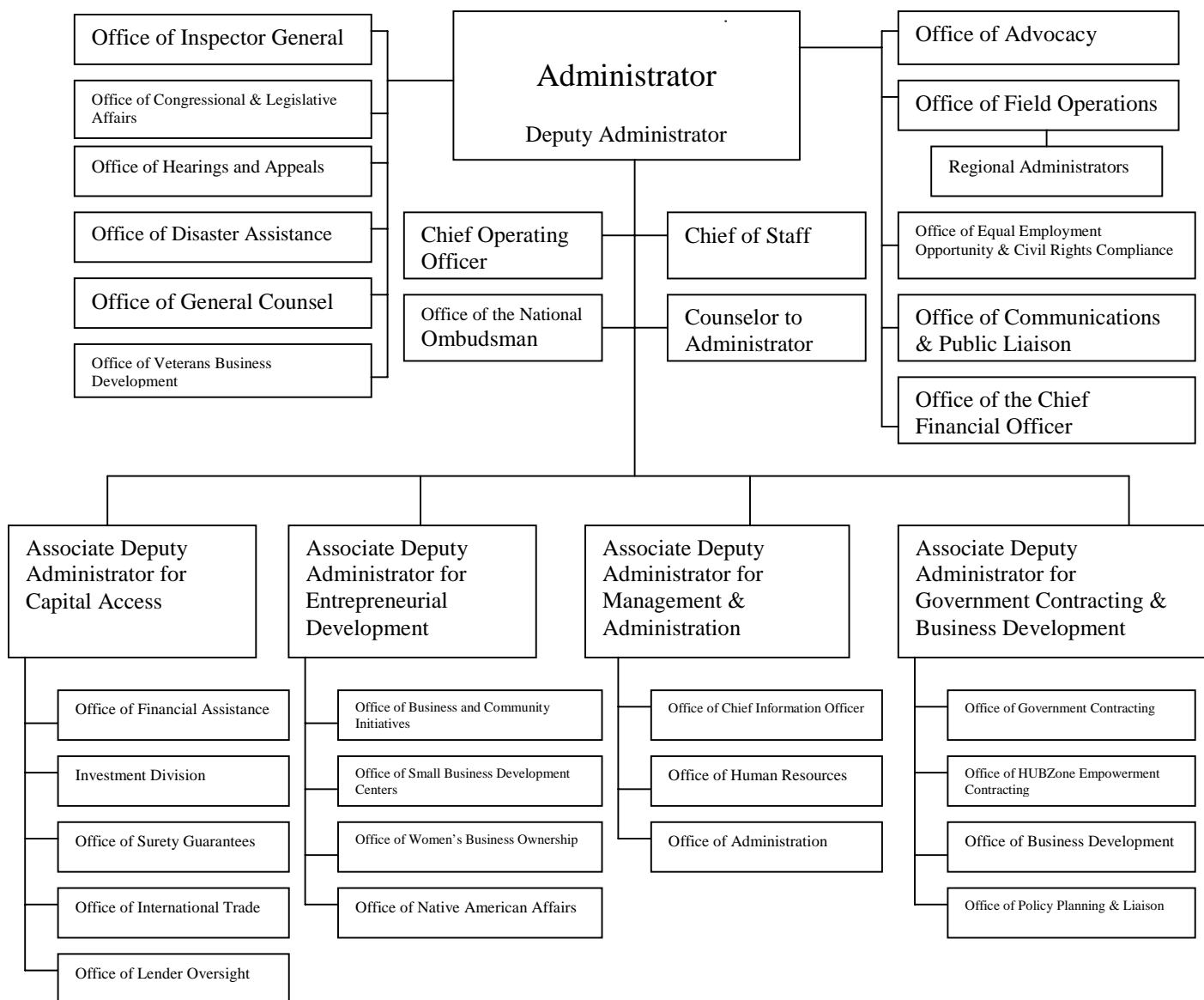


Phyllis K. Fong
Inspector General

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SBA Overview



Agency Overview. The Small Business Administration (SBA) was established in 1953, to assist small businesses from startup through the many stages of growth. SBA's two major goals are to help small businesses succeed and recover from disasters. SBA offers many services to entrepreneurs, including assistance with developing a business plan, obtaining financing, marketing products and services, and addressing management issues. SBA programs are delivered by a network of field offices in every state, the District of Columbia, the Virgin Islands, Guam, American Samoa, and Puerto Rico. SBA has an FY 2002 appropriation of \$768.5 million and has 4,045 employees, including Disaster Assistance and Office of Inspector General (OIG).

The Office of Capital Access has several loan and other programs that assist small businesses. The Section 7(a) program is the largest business loan program. Currently, the Agency is authorized to guarantee up to \$1 million of a small business loan on a loan up to \$2 million. The maximum guarantees are 75 percent for loans more than \$150,000, and 85 percent for loans of \$150,000 or less except for Export Working Capital program (EWCP) loans, which have a 90 percent guarantee. Under Section 7(a) of the Small Business Act (Act), SBA is authorized to offer a variety of specialized products and processes including the Certified and Preferred Lender (CLP and

SBA Overview

PLP), Low Documentation (LowDoc), *SBAExpress*, Community Express, Pre-Qualification, CAPLines, Defense Loan and Technical Assistance (DELTA), Community Adjustment and Investment Loan, EWCP, International Trade Loan, Energy and Conservation Loan, and Pollution Control Loan programs. In addition, Section 7(m) of the Act authorizes SBA to provide loans and grants to not-for-profit organizations that use these funds to provide small loans (currently up to \$35,000) and technical assistance to small businesses. The Small Business Investment Act authorizes SBA to guarantee debentures used to fund long term fixed asset purchases for developing small businesses. The Small Business Investment Company (SBIC) program provides supplemental funding to licensed SBICs who make equity-type investments in small business. All of the specialized business loan programs are intended to provide entrepreneurs with the financing vehicles needed to help them start or grow their small business. The Office of Lender Oversight (OLO) was established to coordinate oversight of the Agency's lending programs. In addition to financial assistance programs, the Office of Capital Access (OCA) oversees the Surety Guarantee (SG) program, the International Trade program, and the Program for Investment in Microentrepreneurs (PRIME). OCA is also responsible for servicing all disaster loans and administering SBA's Asset Sales program.

The Office of Entrepreneurial Development administers programs that offer information, counseling, and management assistance through SBA's many resource partners and district offices. Resource partners include Service Corps of Retired Executives (SCORE), Small Business Development Centers (SBDC), Business Information Centers (BIC), Tribal Business Information Centers (TBIC), and Women's Business Centers (WBC). These resource partners provide guidance and expertise to new entrepreneurs.

The Office of Government Contracting and Business Development administers programs that assist small businesses with Federal procurement opportunities. The Office of Business Development (BD) provides technical and procurement assistance to eligible businesses through two principal programs: (1) BD, which encompasses the Section 8(a) program and the Mentor-Protégé program; and (2) Management and Technical Assistance. BD also includes the Office of Small Disadvantaged Business Certification and Eligibility (SDBC&E), which certifies companies applying as small disadvantaged businesses. The Office of Policy, Planning, and Liaison (OPPL) provides policy support for all of the Agency's procurement assistance programs. OPPL also includes the Office of Technology, which expands the competitiveness of small high technology research and development businesses in the Federal marketplace through two programs: Small Business Innovation Research and Small Business Technology Transfer. OPPL also includes the Office of Size Standards, which reviews and establishes industry size standards. The HUBZone Empowerment Contracting (HUBZone) program is designed to stimulate economic development and create jobs in urban and rural communities by providing contracting preferences to small businesses located in historically underutilized business zones. The Office of Government Contracting (GC) works with Federal agencies to establish and achieve goals for small business participation in Federal contracting. Through its field structure, GC reviews proposed procurements and identifies opportunities for all categories of small businesses.

The Office of Disaster Assistance offers assistance to victims of hurricanes, floods, earthquakes, wildfires, tornadoes, and other physical disasters. SBA's disaster loans are the primary form of Federal assistance for non-farm, private sector disaster losses. SBA is authorized by the Small Business Act to make three types of disaster loans: (1) physical disaster loans, which provide a primary source of funding for permanent rebuilding and replacement of uninsured disaster damages to homeowners, renters, non-farm businesses of all sizes, and nonprofit organizations; (2) economic injury disaster loans, which provide businesses with necessary working capital until normal operations resume after a physical disaster; and (3) pre-disaster mitigation loans. The disaster program is SBA's largest direct loan program, and the only SBA program for entities other than small businesses. SBA delivers disaster loans through four specialized Disaster Area Offices located in Niagara Falls, NY; Atlanta, GA; Ft. Worth, TX; and Sacramento, CA.

Significant Activities and Management Challenges

OIG Strategic Plan

OIG Strategic Plan



OIG's Strategic Plan currently articulates the office's vision to improve SBA's programs by identifying key issues facing the Agency, ensuring that corrective actions are taken, and promoting a high level of integrity. OIG continues to focus on serving the needs of our customers and stakeholders and on safeguarding SBA resources from waste, fraud, and abuse. We strive to provide a work environment in OIG that is conducive to excellent performance by our employees. The three goals in the current Strategic Plan are to: (1) improve the economy, efficiency, and effectiveness of SBA programs; (2) prevent and detect fraud and abuse, and foster integrity in SBA programs and operations; and (3) ensure the economical, efficient, and effective operation of OIG. These goals provide the broad framework of our mission from which we further concentrate our work in the following five cross-cutting areas of strategic focus: (1) financial management systems; (2) information systems and computer security; (3) lender oversight; (4) other selected high-risk issues; and (5) new Agency initiatives. In FY 2001, OIG began work on reevaluating its Strategic Plan. During FY 2002, a main concern of OIG has been to refocus and redefine the priorities of the Office. We anticipate completing the process in the 3rd Quarter of FY 2002.

Top 10 Management Challenges

In accordance with the Reports Consolidation Act of 2000, OIG issued its report on the most serious management challenges facing SBA in FY 2002. To reach a common understanding on what is needed to address the challenges, we developed them with substantial input from SBA officials. The Agency's comments helped us ensure all points of view were carefully considered and that the narrative discussions are accurate. A full discussion of the challenges and how OIG developed them can be found at the OIG website: <http://www.sba.gov/IG/igreadingroom.html>.

OIG continues to report on the Agency's Top 10 Management Challenges and to track the Agency's progress in correcting them.

The management challenges report was issued on January 16, 2002. The progress reported below is as of that date. The 10 challenges identified for FY 2002 are essentially the same as the challenges in the FY 2001 list. The focus of the managing for results challenge for FY 2002 has shifted to implementing and using the guidance developed in FY 2001. Limited progress on this challenge has been made. The Agency appears to be making some progress on five other challenges. These include improving information security controls, modernizing information systems, implementing human capital management strategies, business loan guarantee purchase controls, and improving lender oversight. There has been no measurable progress in addressing the challenge on preventing loan agent and borrower fraud, or on the three Section 8(a) Business Development (BD) Program challenges—access to business development and contracts, clearer standards for economic disadvantage, and pass-through procurement activity. Except for some

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updating and clarification, the Section 8(a)BD challenges remain essentially the same as in previous years.

The FY 2002 challenges are as follows.

Agency-wide Issues

Challenge 1. SBA needs to improve its managing for results processes and produce reliable performance data.

SBA needs to develop effective outcome measures, ensure that its performance data are accurate and reliable, and establish systems to manage for results. The Agency has taken steps to identify more program outcomes, improve performance measures, and increase the accuracy of its data. SBA still needs to implement the agency-wide guidance issued in July 2001, for preparing more effective performance goals and indicators, and ensuring that standards and procedures for data verification, validation, client surveys, and other methods to obtain outcome information are fully implemented.

Challenge 2. SBA faces significant challenges in modernizing its major loan monitoring and financial management systems.

SBA implemented the Joint Accounting and Administrative Management System (JAAMS) on October 9, 2001. JAAMS is a software acquisition project intended to improve SBA's financial management systems. The previous accounting and financial management system used by SBA was becoming obsolete, and the service provider was planning to shut down the system. SBA also had plans to modernize and update its Loan Monitoring System (LMS). LMS was initially planned to include a new loan financial tracking system as a replacement to SBA's Loan Accounting System, as well as a loan monitoring, portfolio analysis, and lender oversight system. LMS is on hold awaiting decisions on its future. SBA has made some progress, but needs to formulate and implement sound procedures for system development and software acquisition for all its systems under development.

Challenge 3. Information systems security needs improvement.

SBA operations depend heavily on the Agency's information systems, and the security of those systems is critical. The Agency has made a substantial commitment of resources for enhancing computer security, providing technical staff support, and developing security training. SBA needs to fully implement its agency-wide systems security program to include assessing risks, establishing and updating policies and controls, promoting awareness, and evaluating security effectiveness.

Significant Activities and Management Challenges

There are four main foci of the Top 10 Management Challenges: agency-wide issues, loan programs, Section 8(a) BD, and fraud deterrence and detection.

Challenge 4. Maximizing program performance requires that SBA fully develop and implement its human capital management strategies.

The nature and scope of SBA's work has changed significantly, requiring a different set of skills in the Agency's workforce. SBA has begun to take the steps necessary to better manage its human capital activities, but needs to do more. The Agency must define what the future SBA will look like. The Office of Human Resources, in partnership with the program and district offices, should then develop a comprehensive human capital strategy that will identify SBA's current and future human capital needs, including the size of the workforce and skill gaps; its deployment across the organization; the knowledge, skills, and abilities needed for the Agency to pursue its missions; and an effective succession planning process.

Loan Programs

Challenge 5. SBA needs better controls over the business loan purchase process.

OIG audits have shown that SBA field offices do not consistently follow Agency requirements when purchasing guarantees from lenders after loan defaults, resulting in purchases that may not be justified and unnecessary expenditures for the Agency. In response to this concern, SBA reports that it has instituted a guaranty purchase review (GPR) process, implemented a guaranty repair tracking system, established an early warning system, and is in the process of improving procedures and training. The Agency needs to ensure that the guaranty is denied or reduced when a lender fails to comply with SBA requirements by continuing to update and implement changes to improve the guaranty purchase process based on the results of the guaranty purchase reviews. Responsibility for taking actions to improve the purchase process is shared by the Office of Financial Assistance (OFA) and the Office of Field Operations (OFO) with the assistance of the Office of General Counsel (OGC).

Challenge 6. SBA needs to continue improving lender oversight.

An effective lender oversight program is critical for ensuring lender activities serve Agency objectives and comply with all rules and procedures. The Agency established an Office of Lender Oversight (OLO), completed the third-cycle Preferred Lender Program (PLP) reviews, started the fourth-cycle of PLP reviews, initiated reviews of selected non-PLP lenders, completed the third cycle of safety and soundness examinations of the non-depository Small Business Lending Companies (SBLC), and implemented a review process that ensures all lenders are reviewed periodically and consistently. Congress stopped additional funding and froze existing funds available for the development of a loan monitoring system because of significant changes in scope and dramatic cost increases in the systems modernization initiative.

Significant Activities and Management Challenges

To have an effective oversight program, the Agency needs to develop and implement the loan monitoring system.

Section 8(a) Business Development

Challenge 7. More participating companies need access to business development and contracts in the Section 8(a)BD program.

The Agency needs to give greater emphasis to business development assistance and ensure a more equitable distribution of contracting opportunities to program participants. The bulk of the dollar value of Section 8(a)BD contracts goes to a relatively small number of companies in the program.

Challenge 8. SBA needs clearer standards to determine economic disadvantage.

New standards for determining economic disadvantage should be established to effectively measure diminished capital and credit opportunities—the definition included in the law. The Agency should: (1) redefine "economic disadvantage" using objective, quantitative, qualitative, and other criteria that effectively measure capital and credit opportunities; and (2) provide sufficient training to SBA staff responsible for evaluating companies.

Challenge 9. SBA needs to clarify its rules intended to deter Section 8(a)BD participants from passing through procurement activity to non-Section 8(a)BD firms.

SBA's rules, while restricting the amount of a contract that a Section 8(a)BD firm may pass through to a non-Section 8(a) firm, allow many non-participating companies to receive substantial financial benefit. SBA intends to include value-added resellers as a legitimate industry under the North American Industry Classification System. SBA needs to tighten the definition of "manufacturing" to preclude the pass-through practice of making only minor modifications to the products of other manufacturers.

Fraud Deterrence and Detection

Challenge 10. Preventing loan fraud requires additional measures, including new regulations and funding.

OIG studies have demonstrated that fraud in the business loan program could be reduced by obtaining criminal background information on prospective borrowers and on loan packagers and other for-fee agents. Specific statutory authority exists to perform background checks on prospective borrowers. OIG believes that the statutory framework already exists for SBA to require background checks of loan packagers and other for-fee agents.

Significant Activities and Management Challenges

OIG's Areas of Strategic Focus

The next section of this chapter details significant OIG accomplishments in the areas of strategic focus under OIG's current strategic plan.

Financial Management Systems

FY 2001 Financial Statements Audit

SBA's FY 2001 financial statements received an unqualified opinion for the sixth consecutive year.

The independent auditors determined that SBA's FY 2001 financial statements presented fairly, in all material respects, the financial position of SBA as of September 30, 2001, and 2000, and its net costs for the years then ended, and the changes in net position, budgetary resources, and financing for the year ended September 30, 2001, in conformity with generally accepted accounting principles.

There were four reportable conditions involving SBA's internal control and its operation. The reportable condition that related to the financial reporting process was deemed a material weakness, as SBA continued to experience difficulties in producing complete, accurate, and timely financial statements. The other three reportable conditions were: (1) SBA's cash flow models used for determining subsidy re-estimates continued to contain errors that remain undetected by SBA; (2) SBA used a small non-representative sample to estimate the amount of excess of the Master Reserve Fund investment earnings over payments to certificate holders from those earnings; and (3) SBA's information system control environment continued to contain areas for improvements. OIG made recommendations to correct these reportable conditions. Further, the auditors determined that SBA's financial management systems did not substantially comply with the Federal Financial Management Improvement Act because: (1) SBA's core financial system was not able to provide complete, reliable, timely, and consistent financial management information for external reporting and managing current information; and (2) significant errors and misstatements were made in SBA's initial financial statements. SBA management generally agreed with the findings and recommendations.

OIG continues to focus on lender oversight as a main element of its strategic plan.

Lender Oversight

Review of an SBA Lender

OIG audited an SBA lender to determine whether the bank was processing and servicing loans in accordance with SBA policies and

Significant Activities and Management Challenges

procedures. To that end, OIG reviewed 12 loans processed and serviced by the bank. The auditors determined that the bank did not process and service the loans in compliance with SBA's policies and procedures. Improvements were needed in the areas of: (1) equity injections; (2) use of loan proceeds; and (3) compensation of packagers, loan service providers, and outside agents. The South Florida District Office agreed with the recommendations and notified the bank to implement corrective action.

Review of SBA Loan Processing

OIG is continuing an audit of all defaulted SBA-guaranteed loans originated by a lender in primarily two offices of the country, purchased by SBA between January 1996, and February 2000. The objective of the audit was to determine if the lender processed the loans correctly. The audit has identified multiple loans that were originated, serviced, and/or liquidated in material non-compliance with SBA rules and regulations. This reporting period, OIG issued audit reports on four separate loans.

The first audit report showed that the lender did not secure a loan with all available collateral as required by SBA. According to Agency policy, when there is a shortfall of business assets, the lender must secure worthwhile available assets owned by the principals. The loan was under secured by \$74,202. The principal, however, had personal assets with an estimated liquidation value of \$83,202 that could have reduced SBA's loss. OIG recommended that the Fresno District Office seek recovery of SBA's guaranty percentage of \$62,401. The district office agreed with the recommendation and suggested a repair to the guarantee by the amount recommended. The lender did not provide comments to the draft report in time for inclusion in the final report.

The second audit report disclosed that the lender approved a loan to an ineligible borrower. Pursuant to SBA policy when the loan was made, a lender should have verified the resident alien status of an applicant to ensure that the principal was authorized to remain in the U.S. for at least half of the maturity of an approved loan. According to the lender's loan file, the principal was only authorized to remain in the U.S. for 2 months after loan approval, instead of the 11 years required for the 22-year maturity. OIG recommended that the Illinois District Office seek recovery of \$308,228. The district office agreed with the recommendation and stated that action would be taken to recover the amount from the lender. The lender did not agree with the finding because the principal's resident alien status did not cause the business to fail. OIG does not agree with the lender's position. The lender had ample information that the applicant was not eligible for the loan. By obligating SBA to guarantee an ineligible loan, the lender inappropriately placed SBA at unnecessary risk.

The third audit report revealed that the lender did not exercise reasonable care in protecting SBA's financial interest by using unsupported information to

Significant Activities and Management Challenges

evaluate the borrower's repayment ability. According to SBA guidance, the ability to repay a loan from the cash flow of the business is the most important consideration in the loan-making process. The lender did not take prudent measures to ensure that the borrower injected equity of \$43,329 into the business as required. OIG recommended that the Dallas/Fort Worth District Office seek recovery of \$116,772, less any subsequent recoveries for the loan in question. The district office agreed with the recommendation.

The fourth audit report showed that the lender did not ensure that the borrower injected the required amount of equity into the project. The lender was required to obtain evidence that the principal injected \$255,000 of equity into the business prior to the first loan disbursement. The borrower submitted an accounting of equity injection expenditures for the project of \$447,331. A review of the documentation in the lender's loan file showed that only \$191,503 of the expenditures qualified as equity injection. As a result of eliminating the unqualified expenditures, the equity injection shortfall was \$63,497. OIG recommended that the Colorado District Office seek recovery of \$63,497 on the guaranty paid, less any subsequent recoveries. The district office agreed with the recommendation.

OIG continues its commitment to supporting the national law enforcement response to the September 11, 2001, terrorist attacks on our Country.

Other Selected High-Risk Issues

OIG Participates in National Law Enforcement Response to Terrorism

OIG made significant contributions to the national law enforcement response to the terrorist acts on our Country on September 11, 2001. Our contribution during the past 6 months included the following.

- Nearly 500 hours of criminal investigator work on the Federal Bureau of Investigation (FBI)-led New York City task force.
- Detail of a criminal investigator to serve as an interim air marshal while the Federal Aviation Administration was expanding its permanent cadre.
- Coordination with FBI offices as to available information on known or suspected terrorist accomplices, focusing on proactive steps to prevent the use of SBA loans to fund terrorist-related organizations.
- Assisting the SBA Disaster Assistance response to small businesses harmed by the events, by instituting a variety of fraud deterrence activities. OIG is planning to devote additional resources, pending funding, to oversight of the Disaster Assistance program as physical and economic injury disaster loan volume increases.

Significant Activities and Management Challenges

Agency Initiatives

Asset Sales Audit

OIG issued an audit advisory memorandum detailing the results of a certified public accountant (CPA) firm's review of one of the Agency's asset sale contracts. SBA hired the CPA firm to verify the billings of the contract. OIG reviewed the CPA's work and brought to management's attention two situations where the CPA's work was not adequate. Specifically, OIG noted that the CPA used computer-generated data provided by the contractor to support its review results without performing tests to ensure data reliability. Additionally, OIG noted that the CPA's conclusion that the contractor over-billed by \$620,996 was in error because the CPA had made miscalculations when checking the billings. OIG recommended that the Associate Administrator (AA)/OFA ensure that the contractor's database be validated and transaction testing be accomplished to ensure data accuracy and reliability prior to reaching a negotiated settlement with the contractor on the reviewed asset sale. The contract review process is on-going.

In response to a Congressional request, OIG assesses the Agency's efforts to reduce erroneous payments.

Efforts to Identify and Reduce Level of Erroneous Payments

The Senate Committee on Governmental Affairs requested agencies and their OIGs to assess their efforts in identifying and reducing the level of erroneous payments. In its response, the Agency acknowledged that it does not have estimates of the amount of improper payments made in the last 2 years in the Section 7(a) Business Loan, Section 504 Certified Development Company, Small Business Investment Company (SBIC), and Disaster Assistance Programs. OIG concurred with this assessment and made a commitment to work with the Agency to develop processes to identify such estimates.

OIG Profile

There are five divisions of SBA/OIG.

SBA/OIG was established by the Inspector General (IG) Act of 1978. OIG provides nationwide coverage of SBA's programs and activities. In addition to the Immediate Office of the IG, OIG's five divisions work together to perform the missions mandated by Congress.

- **Auditing Division** provides comprehensive audit coverage of SBA's operations through program performance reviews, internal control assessments, and financial and mandated audits to promote the economical, efficient, and effective operation of SBA programs. Audits give SBA managers an objective and systematic assessment of how well their offices are carrying out their programs and operations. Financial audits examine the presentation of financial information, internal controls, and adherence to financial requirements. Performance audits assess operations in terms of economical and effective use of resources.
- **Investigations Division** manages a nationwide program to prevent and detect illegal and/or improper activities involving SBA programs, operations, and personnel. The criminal investigative staff carries out a full range of traditional law enforcement functions, including (in the last 2 years) executing 22 arrest warrants, 5 search warrants, and 2 electronic monitorings. The security operations staff ensures that all Agency employees have the appropriate background investigations and security clearances for their duties. The name check program provides SBA officials with character-eligibility information on loan applicants and other potential program participants.
- **Inspection and Evaluation Division** conducts assessments of the effectiveness of SBA programs and activities, analyses of critical program issues, best practices studies, and research on matters concerning SBA performance.
- **Counsel Division** is an in-house legal staff that provides legal advice and assistance to all OIG components, represents OIG in litigation arising out of or affecting OIG operations, processes Freedom of Information and Privacy Act requests, and manages OIG legislative and regulatory review functions.
- **Management and Policy Division** provides planning, information systems, budgetary, administrative, personnel, and communications services.

OIG Profile

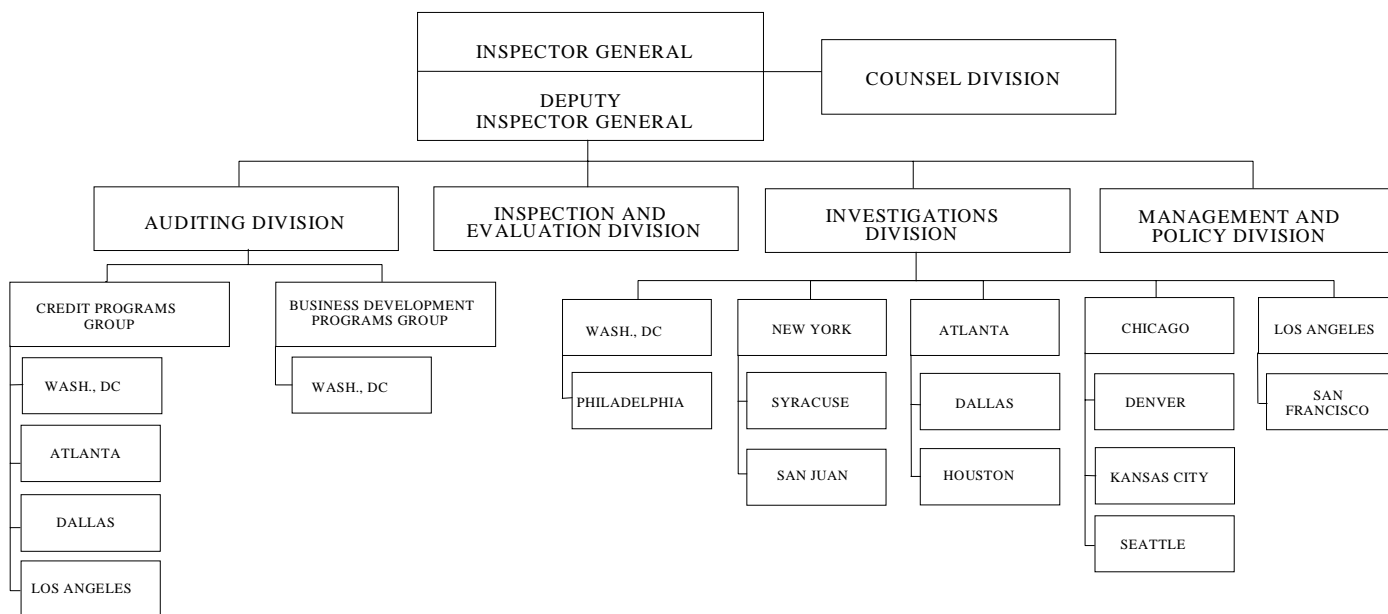
SBA/OIG has offices nationwide.

OIG is headquartered in Washington, DC, and has field audit and investigation offices in Atlanta, Chicago, Dallas, Denver, Houston, Kansas City, Los Angeles, Philadelphia, New York, San Francisco, San Juan, Seattle, and Syracuse.

SBA/OIG resources.

As of March 31, 2002, OIG's on-board strength was 107. The OIG FY 2002 appropriation was \$11.5 million, with a \$500,000 transfer for disaster assistance oversight activities.

OFFICE OF INSPECTOR GENERAL SMALL BUSINESS ADMINISTRATION



OIG Activities

This chapter includes details and results of audits, investigations, inspections, and other significant OIG activities that do not fall under the strategic plan's focus points. The material in this chapter is organized by major SBA program area. Many of the audits, inspections, and other materials discussed in this section can be found at <http://www.sba.gov/IG/igreadingroom.html>.

Business Loan Programs

OIG continues to monitor three types of fraud in SBA's loan programs.

Over the years, OIG investigations of fraud in SBA's loan programs have identified trends or types of fraud. Three major trends in recent years are: (1) fraud involving borrowers who do not disclose criminal histories; (2) fraud involving loan agents; and (3) fraud involving false tax returns. The first two trends are reflected in SBA's Management Challenge 10.

OIG is reporting more than \$19 million in cost avoidances this 6-month period; \$10.3 million of these avoidances were in the loan programs and resulted from six investigations in four SBA districts. They fall into two categories: (1) loans under investigation, where the lender notified SBA that it would not submit claims for guarantees; and (2) loans that were not disbursed because of adverse information OIG was able to document quickly.

Fraud Involving Borrowers Who Do Not Disclose Criminal Histories

During this period, OIG investigations of criminal record fraud in connection with SBA's business loan programs yielded four indictments, one conviction, and \$83,203 in court-ordered restitution to SBA and a participating lender. Summaries of some of OIG's criminal history fraud investigations involving SBA loan programs are listed below.

- Four Illinois men (a restaurateur and three attorneys) and a defunct Illinois corporation were indicted on charges including two conspiracies, mail fraud, wire fraud, bankruptcy fraud, making material false statements, and obstruction of justice in connection with the sale of an Antioch, Illinois, restaurant/bar financed, in part, with an SBA-guaranteed loan. The restaurateur was charged with making material false statements to SBA in his loan application regarding his citizenship status, criminal history, and pending felony charges. OIG initiated the investigation based on referrals from SBA's Illinois District Office and an anonymous caller.
- A California produce business owner whose Los Angeles, California, business had received a \$225,000 SBA-guaranteed bank loan was arrested by OIG special agents and Los Angeles Police Department

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officers. He had been a fugitive since 1984, wanted on a Nevada felony warrant for leaving the scene of an automobile accident. The defendant pled guilty to that charge (in return, his “driving under the influence” charge was dropped) but, facing a 1- to 6-year prison term, fled prior to his sentencing. His SBA-guaranteed loan came under scrutiny in the spring of 2001. A criminal history check, processed by OIG’s Office of Security Operations (OSO) in support of the investigation, disclosed his lengthy criminal record. The Immigration and Naturalization Service denied his application for permanent resident status in 1993, because of his criminal record. In applying for his SBA-guaranteed loan, OIG’s investigation found that he falsely declared he was a U.S. citizen and falsely answered “No” to the criminal history questions on SBA Form 912. Believing that the owner of the produce business was the fugitive from the Nevada felony warrant, OIG contacted the Clark County (Nevada) District Attorney’s office, which provided confirming booking photos and fingerprints and committed to prosecute him if he were arrested and extradited. Both of those events have happened and OIG’s investigation is continuing.

Pet store owner convicted of bank fraud and making false statements in connection with a \$100,000 LowDoc loan.

- The president of a pet store in Stow, Ohio, was convicted on one count of bank fraud and one count of making false statements to SBA in connection with his \$100,000 LowDoc loan. He was sentenced to 14 months imprisonment, 3 years supervised release, and \$83,203 restitution. The jury found that he concealed both an outstanding promissory note and information regarding his criminal history. The outstanding balance of the promissory note at the time he applied for the SBA-guaranteed loan was approximately \$200,000. OIG initiated this investigation based on a referral from SBA’s Cleveland District Office.

Fraud Involving Loan Agents

Loan agents provide referral and loan application services to prospective borrowers or lenders for a fee. Some agents, particularly loan packagers, have been involved in a variety of fraudulent schemes that have resulted in financial losses to SBA and, ultimately, the taxpayers. During this reporting period, OIG investigations of loan agent fraud resulted in two convictions and \$46,500 in restitution to SBA. The following cases illustrate OIG investigations of fraud involving business loan agents.

- An Arizona couple pled guilty to one count of money laundering and making material false statements, respectively. As part of their plea agreements, the Government agreed to dismiss the other 14 felony charges and the forfeiture count in their indictment. The investigation, based on a referral from SBA’s Arizona District Office, showed that the couple, operating as a business brokerage firm in Phoenix submitted fraudulent documents to private lenders in order to obtain financing for

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clients seeking business acquisition loans guaranteed by SBA. The couple allegedly came up with a “no money down” plan for clients interested in purchasing a business at 100 percent financing who would have otherwise not qualified for the loan or lacked the funds for a down payment and cash injection as required for approval of the SBA-guaranteed loans. The investigation found approximately \$2.9 million in loans brokered by the couple to small-business owners in Arizona. At present, approximately \$2.5 million may not be collectible, and SBA expects losses as a result.

- A licensed real estate agent and business broker in the Cleveland, Ohio, area was sentenced to 2 years imprisonment, 2 years probation, and \$46,500 restitution to SBA. A jury previously found her guilty of making false statements to SBA and conspiracy to defraud the Government. She and three others had been indicted in connection with a scheme to facilitate a \$326,000 SBA-guaranteed loan to a man for the purchase of a forklift sales and service business in Parma, Ohio, from a married couple. The scheme to fraudulently provide the purchaser with the funds for his required capital injection prior to the loan closing enabled all the defendants to benefit from the completion of the transaction. It essentially provided him with 100 percent financing and resulted in inflation of the contract sales price, thereby exposing SBA and the participating lender to additional loss and reduced recovery potential. The benefit to the couple was the sale of their business; the benefit to the real estate agent/business broker was her commission. This scheme to defraud SBA and the participating lender was also facilitated by each of the subjects’ concealment of the transfer of funds from the couple to the purchaser, and their supporting false statements to the participating lender and SBA. OIG initiated its investigation based on a referral from SBA’s Cleveland District Office.

Fraud Involving False Tax Returns

Over the last 11 ½ years, OIG has received more than 525 allegations that false tax returns were submitted in support of SBA applications (more than 98 percent for business or disaster loans). These fraud referrals involved applications totaling approximately \$130 million that were submitted to 59 SBA offices. To date, 170 individuals have been indicted on criminal charges, 151 have been adjudicated guilty, 7 indictments were dismissed, 1 defendant was acquitted, and 11 others have not yet gone to trial. Restitution and fines from those adjudicated guilty total nearly \$28.2 million. Because of the implicit credibility of Federal tax returns, SBA has traditionally relied heavily on information they contain in making its credit-related decisions, so falsification of “copies” of returns can have a significant impact on SBA’s consideration of those applications. During the last 6 months, OIG investigations of tax-return fraud generated one indictment, two convictions, and more than \$1.6 million in savings and restitution.

In the past 11 ½ years, OIG investigations have resulted in \$28.2 million recovered in restitution and fines.

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The following cases illustrate OIG's work on fraud involving false tax returns.

- The president of a Middletown, Pennsylvania, business that makes and sells Civil War era clothing was indicted on one count of making a material false statement to SBA. In 2000, she applied for a \$243,000 SBA-guaranteed loan to purchase land. She allegedly submitted false Federal tax returns for 1997, through 1999. This was discovered when the lender bank found discrepancies between the copies submitted and those on file with the Internal Revenue Service (IRS). The lender cancelled the loan before it made any disbursements. OIG initiated this investigation based on information received from the bank.
- The owner of an auto service center in Irving, Texas, was sentenced to 2 years incarceration followed by 3 years supervised release. Six months earlier, a jury had found her guilty on one count of conspiracy and five counts of making material false statements to induce a non-bank participating lender and SBA to fund a \$156,000 SBA-guaranteed loan. She had submitted 3 years of falsified tax returns and IRS tax return verifications, along with fraudulent documentation of the required capital injections and equipment purchases. Proceeds of the loan were used for personal expenditures not related to the business.
- A former Pasadena, California, tax preparer whose clients included SBA loan applicants was sentenced to serve 8 months in prison and to pay a \$2,000 fine and \$600,000 in back taxes to IRS. He had pled guilty in 1999, to one count of conspiracy to defraud IRS and eight counts of tax evasion. In 1996, OIG was asked to join a criminal investigation which suggested that the defendant was responsible for the preparation of altered tax returns submitted to financial institutions and to SBA on behalf of southern California clients who had received SBA-guaranteed loans. Two of those borrowers, whose SBA-guaranteed loans totaled more than \$1 million, each pled guilty to bank fraud in 1998. The investigation had confirmed that "copies" of their Federal tax returns, submitted to participating lender banks with their loan applications, had been altered from those submitted to IRS to substantially overstate their incomes. These discrepancies formed the basis for a search warrant that was executed on the tax preparer's business. The charges on which he was sentenced were a direct result of the evidence gathered during the search.

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Other Types of Fraud

The following cases illustrate OIG investigations involving fraud to obtain business loans.

- A Virginia Beach, Virginia, chiropractor was sentenced to 5 years probation (the first 6 months under home confinement with electronic monitoring) and \$136,617 restitution. He previously pled guilty to one count of making a false statement under oath in bankruptcy. He had submitted false equipment invoices and a false building lease in support of his application for a 1996 SBA-guaranteed loan of \$337,000 to purchase equipment. Upon receiving the two-payee disbursement checks for the loan, he forged the endorsement of the equipment company and deposited the checks into his personal account. He subsequently defaulted on the \$136,617 balance of the loan. His scheme was revealed when he filed bankruptcy in 1999. OIG's investigation was based on a referral from the U.S. Bankruptcy Trustee in Norfolk, Virginia.
- The former co-owner of a dry cleaning business in Southington, Connecticut, pled guilty to one count of making a false statement to a bank. She was sentenced to 3 years probation and \$100,000 restitution. The business obtained a \$100,000 SBA-guaranteed loan through a Connecticut bank. The defendant stated to the bank that she and her co-owner had previously purchased \$98,000 of new equipment using their own funds and needed the \$100,000 for working capital. The investigation revealed that the defendant submitted false documents to the bank, representing their capital injection into the business. Further, 1 month prior to obtaining the SBA loan, the defendant and her co-owner had obtained an \$85,000 loan through a private lender using a different company name with which they purchased various pieces of equipment. The private lender was given first lien position on the collateral, but the business did not disclose this debt relationship in its SBA loan application. It then pledged the same equipment to the bank. When the business defaulted on the SBA loan, neither the bank nor SBA were able to recover any of their losses because the private lender had obtained and sold the equipment. OIG initiated the investigation as a result of a referral from SBA's Connecticut District Office.

The following cases illustrate OIG investigations involving acts after business loans were approved.

- The president and owner of a now-defunct wholesale meat distribution company in Cumming, Iowa, was convicted on four of five felony counts. He was sentenced to 63 months in prison, 5 years on probation, and \$1.23 million restitution to SBA's participating lender bank.

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The jury found him guilty of concealing a material fact from SBA, bank fraud, embezzlement, and money laundering. In connection with a \$1.4 million SBA-guaranteed loan he received from a bank in 1997, to purchase the company, the defendant wrote an insufficient-funds check and perpetrated a “check-kite” to make it appear he had made a required \$300,000 equity injection. In 1998, he converted vehicles pledged to the successor to the original lending bank on this same loan. In 1999, he embezzled \$483,486 from the pension plan of another meat distribution business he owned. Then he laundered the money he had embezzled. The jury acquitted him on the count alleging that in 1998, he transported monetary instruments of more than \$10,000 outside the U.S. without filing a Report of International Transportation of Currency. Following the verdict, the judge found that the \$486,486 that he feloniously obtained from the second meat distribution company’s pension plan was subject to forfeiture to the U.S. Both companies failed and he defaulted on his SBA-guaranteed loan, leaving an unpaid balance of about \$1.25 million. OIG initiated this investigation based on a referral from SBA’s Iowa District Office.

- The president of a roadside construction company in Louisville, Kentucky, his brother, and a guarantor were indicted on one count of conspiracy to defraud the Government with respect to claims. The president and the guarantor were also charged with five counts of fraudulent claims and five counts of conversion of Government property. The brother was additionally charged with one count of misappropriation of SBA collateral. The president subsequently pled guilty to one count of conspiracy to defraud the Government with respect to claims; his brother most recently pled guilty to one misdemeanor count of misappropriation of SBA collateral. As part of their plea agreements, the Government will dismiss the other counts on which they were indicted. In 1997, the president and the guarantor obtained \$250,000 in SBA-guaranteed bank loans. The three allegedly conspired to defraud SBA by submitting fraudulent invoices to induce disbursement of the loans. Allegedly, the guarantor and the president submitted five fraudulent invoices claiming that they purchased office furniture, computer equipment, and a backhoe. In fact, they falsified invoices using employee names as merchants and then falsely negotiated the joint payee loan checks. In addition, the guarantor and the president allegedly allowed a company vehicle to be individually titled to the brother and proceeds from sale of the vehicle to be retained for personal use. OIG initiated this investigation based on information received from SBA’s Kentucky District Office.
- The president of a defunct Bensalem, Pennsylvania, ship repair business and a shipbuilding business in Guam, honored a settlement agreement by paying a participating lender bank almost \$2 million. The ship repair business, an SBA-certified Section 8(a) firm, had a revolving line of

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credit loan agreement with the bank totaling approximately \$7.5 million. This business also obtained a \$650,000 SBA-guaranteed loan through the bank in 1997. It defaulted on both loans and filed for bankruptcy in 1999. The bank referred the matter to the U.S. Attorney's Office, Eastern District of Pennsylvania, at whose request OIG joined the resulting investigation. The investigation revealed that proceeds from the line of credit and the SBA-guaranteed loan were transferred to the ship building company without the knowledge and permission of the bank or SBA. At the settlement closing, releases were executed and the president then provided the bank with an almost \$2 million cashier's check. The bank applied \$80,000 of these proceeds to reduce the SBA-guaranteed loan amount. Based on the president's settlement agreement with the bank and SBA, the U.S. Attorney's Office declined prosecution.

The following case illustrates OIG investigations involving fraud by business lenders.

- The former executive director of a microlender of SBA funds in Manchester, New Hampshire, pled guilty to one count of submitting material false statements. In accordance with his plea agreement, the Government dismissed the other counts of submitting material false statements and conversion of funds on which he had also been indicted. He was sentenced to 4 years probation, 150 hours community service, and \$28,336 restitution to SBA. This is the first conviction in the 10-year history of SBA's Microloan Program, which provides short-term small loans to entrepreneurs via SBA-approved, nonprofit intermediaries known as microlenders. As the executive director, the defendant was required to report to SBA on a quarterly basis the balances of the bank accounts established to manage the microloan funds. SBA uses these reports to monitor the microlender's performance and liquidity. According to his indictment, between November 1996, and March 1997, he knowingly submitted material false statements to SBA by vastly overstating the actual balances of the microloan accounts. The indictment also charged that from December 1995, to December 1996, he converted to his personal use \$13,042 in microloan funds. In June 1997, the microlender became insolvent and SBA took over administration of its loan portfolio. OIG initiated this investigation based on information provided by SBA's OFA and SBA's New Hampshire District Office.

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Disaster Loan Program

Early Defaulted Disaster Loan Audits

OIG issued two audit reports on early defaulted disaster loans. The objective of the reviews was to determine whether the loans defaulted due to SBA non-compliance with its policies and procedures, borrower non-compliance with the loan agreement, or borrower misrepresentations.

The first report was on a disaster loan that defaulted soon after approval. OIG identified four issues warranting management's attention:

(1) unverified information relied on to determine borrower benefits; (2) use of loan proceeds for unauthorized purposes; (3) lack of support for 80 percent of funds received; and (4) false statements by the borrower that were not referred to OIG. OIG requested that the program office maintain documentation of any actions taken for future OIG review and follow-up.

The second report was on a disaster loan that defaulted because of a lack of repayment ability. This occurred because an SBA loan officer miscalculated a portion of the borrower's wages and there was a discrepancy in financial information reported on the application that was not reconciled with wages shown on the Federal tax return. Consequently, the wages used to calculate repayment ability were overstated. OIG recommended that SBA periodically remind disaster loan officers of the importance of following all established SBA loan-making procedures.

The following cases illustrate OIG investigations of fraud to obtain disaster loans.

- An Albuquerque, New Mexico, woman was found guilty on all 23 counts charged in her October 2001 indictment: 7 counts of money laundering, 5 counts of wire fraud, 6 counts of mail fraud, 2 counts of impersonation of a Federal employee, 1 count of filing false claims, 1 count of making material false statements, and 1 count of false representation of a Social Security number (SSN). The charges relate to her schemes attempting to obtain post-disaster assistance, including the application that resulted in her \$40,000 SBA disaster home loan. The defendant, using the name and SSN of a deceased acquaintance, applied for disaster assistance from SBA and the Federal Emergency Management Agency (FEMA) under the Cerro Grande Fire Assistance Act. The defendant submitted numerous false documents in support of her damage claim; she also attempted to obtain information about her claim and investigation by posing as a representative of the U.S. Attorney's Office. The investigation determined that neither she nor her deceased acquaintance ever resided at the address claimed in the disaster

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assistance application. FEMA/OIG asked SBA/OIG to assist in the investigation.

- A North Haven, New York, man pled guilty to a criminal information charging him with one count of wire fraud and two counts of bank fraud. The charges related to a scheme to defraud SBA of disaster loan funds. He had assisted a physician practicing in California, who rented a New York City apartment from him, with the care of her elderly mother during 1999, and 2000. When the elderly lady's home in Cortland Manor, New York, was damaged by a hurricane in late 1999, she applied with the help of her daughter for an SBA disaster loan. The defendant became involved in the details of the loan when the physician had to return to California. He submitted altered invoices for work purportedly performed on the elderly woman's home. His false statements led SBA to lend the elderly woman \$78,300. He then fraudulently wrote and endorsed checks from the elderly woman's bank account and used loan proceeds to pay for repairs at his residences and other personal expenses. The investigation was initiated based on a complaint by a member of the public.
- A Paradise Valley, Arizona, couple was sentenced, the husband to 18 months in prison and the wife to 5 months in prison followed by 5 months of home detention. They were ordered to pay SBA \$40,000 within 120 days and \$1,000 per month thereafter until the loan balance of \$203,500 is repaid. The husband was previously convicted on one count of mail fraud; his wife had pled guilty to four counts of mail fraud. The couple had obtained a \$231,300 disaster home loan after the 1994 Northridge, California, earthquake. OIG's investigation revealed that they had submitted a series of false invoices to SBA indicating that various contractors had done work when in fact they had not. The couple also received two loan payment deferments from SBA. Both times they claimed they had no money or assets. The investigation later revealed that the couple owned five properties in the Phoenix, Arizona, area that were not disclosed to SBA. OIG initiated the case based on a referral from SBA's Santa Ana Loan Servicing and Liquidation Center.

Small Business Investment Companies

The following narratives illustrate OIG investigations involving fraud by principals of SBICs.

- The former president of a now-defunct New York City SBIC was sentenced to 2 months incarceration and 3 years supervised release (the first 6 months under home confinement). He was also ordered to pay \$953,274 in restitution to SBA. He previously pled guilty to one count of embezzlement of SBIC assets. The count to which he pled guilty involved an illegal transfer of a New York property valued at

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\$361,296 from the SBIC without consideration to another company wholly owned by him. This and other actions of the defendant caused a loss to SBA of more than \$1 million. This investigation originated from a referral from SBA's OGC.

- A former board member of a defunct specialized SBIC in Rockland County, New York, pled guilty to one count each of conspiracy and mail fraud. The charges relate to his participation in schemes to defraud the Government of tens of millions of dollars from various Federal programs, including SBA's SBIC program. The plea resolved his 1997 indictment (along with six other defendants including his son) on 21 counts of conspiracy, embezzlement of Federal program funds, making material false statements, mail fraud, wire fraud, mortgage fraud, and money laundering. As a board member of the specialized SBIC, the board member misappropriated SBA funds by extending loans to small businesses affiliated with the SBIC's officers and directors and concealed these improper loans by submitting fraudulent documents to SBA. He also loaned SBA funds to enterprises that were not independently controlled by private business owners but instead were affiliated with a religious school, a not-for-profit entity ineligible to receive SBA funds. The SBIC also made loans to small businesses that, in turn, improperly paid a portion of the loan proceeds to the religious school or to related entities. When he failed to appear in court to face the charges in his 1997 indictment, a warrant was issued for his arrest. He was located in Israel, where he had obtained Israeli citizenship, and was arrested by Israeli police in February 1999, in response to a formal request submitted by the U.S. Department of Justice. After extensive legal proceedings, the Supreme Court of Israel ordered his extradition, and he was returned to the U.S. in November 2001. He was one of the first fugitives to be extradited to the U.S. under an Israeli law enacted in April 1999, which permits the extradition of Israeli citizens. SBA/OIG's investigation was based on information received from IRS.
- The former owner of an SBIC in Washington, DC, and his wife signed a settlement agreement to pay SBA \$490,000. The former owner made the first payment of \$50,000 on that day and agreed to pay the remainder in two installments. If he does not adhere to the terms of the agreement, he will forfeit the \$50,000 already paid to SBA, and an earlier judgment will be enforced against him. The joint efforts of OIG and the SBA Investment Division resulted in the settlement described above.

Proposed Rule Amending Regulations for the New Markets Venture Capital Program

OIG reviewed a proposed rule amending the regulations for the New

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Market Venture Capital (NMVC) program. While generally supportive of the proposal, OIG was concerned that a proposed change would allow non-cash capital contributions to be included in the definition of regulatory capital. By accepting non-cash items as regulatory capital, SBA increases the capital base of a licensee when computing capital impairment. This could be a significant factor if the ratio of the non-cash capital to cash capital is material. OIG suggested that the NMVC program consider establishing a limit on the dollar amount of non-cash contributions allowed to be included as regulatory capital. Such a limit should ensure that the non-cash items would not significantly impact the impairment calculations. Program officials addressed OIG comments by narrowing the proposed rule to allow only organizational and management expenses paid on behalf of a NMVC company before it achieves final approval to be included in the definition of regulatory capital.

Surety Guarantees

Preferred Surety Bond Company Audits

OIG issued two audit reports on preferred surety bond companies. Both audits found that the surety correctly calculated and timely remitted fees to SBA and that the surety did not always comply with SBA regulations for underwriting and servicing bonds and processing claims. In the case of the first company audited, OIG found that it: (1) did not request and maintain status reports for one bond; and (2) made a duplicate claim payment on one bond that was reimbursed by SBA. In the case of the second, OIG found that it did not: (1) maintain copies of required SBA forms for one bond; and (2) notify SBA of default for one bond in a timely manner. For the first company, OIG recommended that SBA take appropriate actions to recover \$2,837.01. For both companies, OIG suggested that SBA advise the company to implement, review, revise, and adhere to policies and procedures to correct the deficiencies. The Associate Administrator for Surety Guarantees agreed to implement the recommendations of both reports upon completion of the audit.

The following narrative illustrates OIG investigations of fraud to obtain surety bond guarantees.

- The president of a Birmingham, Alabama, construction company was convicted on one count of making a material false statement to fraudulently influence SBA to guarantee five surety bonds totaling nearly \$1.2 million from an insurance company in Cincinnati, Ohio. (Before his conviction, the judge dismissed the two counts of making false statements to SBA on which he was also indicted.) On the SBA application, the defendant denied having a criminal history. The investigation documented that he had been charged with, arrested for,

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and/or convicted of at least 29 criminal offenses. The dismissed counts alleged that he submitted a financial statement fraudulently indicating ownership of two pieces of real estate with a total value of \$450,000. His company failed to complete any of the bonded contracts, and the insurance company paid \$324,170 on these bonds. The insurance company is in SBA's preferred surety program, and the bonds issued for the defendant were guaranteed at 70 percent. This investigation was based on findings of a surety bond audit by OIG's Auditing Division.

Entrepreneurial Development Programs

Women's Business Center Advisory Memorandum

OIG issued an advisory memorandum on SBA's evaluation and monitoring of a women's business center in Vermont, based on issues identified during a previous audit of the center. The audit disclosed deficiencies that could be applicable to all women's business centers in the areas of: (1) reviewing proposed budget and cost information; (2) reviewing staffing roles and experiences; and (3) monitoring the financial and performance aspects of the award. For this reason, the auditors made eight recommendations to the AA/Office of Women's Business Ownership (OWBO) and three recommendations to the Assistant Administrator for Administration to help strengthen the administration of the Women's Business Center Program. OWBO agreed with all of the recommendations addressed to them. The Office of Administration agreed with one of the recommendations addressed to them and provided a rebuttal with supporting documentation for the other two. The auditors analyzed the rebuttal and supporting documentation and determined that the recommendations should remain.

Government Contracting and Business Development Program

OIG reported more than \$19 million in cost avoidances this period, \$8.7 million of which were a result of investigative work in connection with the Section 8(a)BD program. The amount reflects military construction contracts that were cancelled and other contracts that were in line to be awarded but were denied based on OIG's investigative findings.

The following cases illustrate OIG investigations of fraud in connection with the Section 8(a)BD program.

- The president of a former Section 8(a) contractor was sentenced to serve

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6 months in home detention and 3 years on probation. He was also fined \$2 million and ordered to pay \$963,197 in outstanding fines relating to a 1993 bribery conviction. (The defendant paid the \$2 million fine before his sentencing.) He previously pled guilty to one count of obstruction of a Federal audit. He admitted that, from 1993, to 1995, he had directed his staff to obstruct Environmental Protection Agency (EPA) auditors attempting to determine the appropriateness of the company's billings under EPA contracts. He and five associates had been indicted on charges of racketeering, racketeering conspiracy, money laundering, bank fraud, mail fraud, and obstruction of a Federal audit. A prosecution under the Racketeer Influenced and Corrupt Organizations Act involves allegations that a group of persons formed an "enterprise" which then engaged in a series of corrupt or illegal activities. In this case, he initially entered SBA's Section 8(a) program in Ohio in 1980, as primary owner of the company, a hazardous-waste cleanup contractor. The indictment alleged that in the late 1980s, shortly after the company was "graduated" from the program, he obtained (in the name of his son and codefendant to conceal his role) Section 8(a) status in Kentucky, and later in California, for another company he controlled. The indictment further alleged that another waste cleanup company purportedly headed by the defendant's other son and codefendant fraudulently obtained Section 8(a) status in Kentucky. As of the date of the indictment, these Section 8(a) companies had been awarded Federal contracts totaling more than \$150 million. Pursuant to the defendant's plea agreement, at his sentencing the Government dismissed all the other charges of the indictment against him and his codefendants.

- A Poplar Bluff, Missouri, Section 8(a) company and its president pled guilty to three counts each of mail fraud. They were previously charged in a 12-count felony indictment that also included counts of major fraud against the U.S., obtaining illegal kickbacks, and making material false statements. In the plea agreement, the president admitted to devising a scheme to fraudulently obtain money from insurance companies that insured the company's property and equipment. As part of the plea, the president and his company agreed to make restitution totaling \$13,101 to two insurance companies and to repay \$669 that he wrongfully withheld from two of his employees. He also agreed to pay fines totaling \$250,000. In exchange for the Government's promise to dismiss the remaining counts of the indictment, the president and his company further agreed to voluntarily withdraw and forever be barred from participation in SBA's Section 8(a) and other programs, including all SBA certifications, assistance, and resources. The company also agreed to surrender all surplus property obtained as a result of their certification in the Section 8(a) program. The Army suspended both the company and its president from future contracting with any executive branch Federal agency. The Army also suspended both the president and the company from non-procurement Government assistance. Debarment proceedings are pending against them. As a result of the suspensions,

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military-service procurement offices cancelled Section 8(a) contracts that had already been approved for the company by SBA and were valued at a total of more than \$3.75 million. SBA's St. Louis District Office has taken action to deny the company its latest Section 8(a) contracts, also from the military, valued at as much as \$4.9 million.

- The president of a defunct Hunting Valley, Pennsylvania, construction company was indicted on one count of making a material false statement to SBA. He allegedly represented in his SBA Section 8(a) Annual Update form and attachments that he had relocated to Pennsylvania along with his Section 8(a) certified business and that he controlled the day-to-day operations of the company. The indictment charges that he never relocated to Pennsylvania from Michigan and that he had a friend run the daily affairs of the business. The identity and role of his friend were not made known to SBA. The friend who controlled the business was not eligible to participate in the Section 8(a) program because he had already graduated from the program and would not be considered disadvantaged. This investigation was referred by the Veteran's Administration OIG and is continuing.

Proposed Rule to Amend the Regulations for the Historically Underutilized Business Zone Program

OIG reviewed a proposed rule addressing changes in the Historically Underutilized Business Zone Empowerment Contracting (HUBZone) program. The proposed rule sought to clarify certain regulations and make some technical changes. OIG was concerned with a proposed provision that would enable the Agency to utilize different percentages of prime contractor performance requirements (limitations on subcontracting) if the Administrator determines that such action is necessary to reflect: *“conventional industry practices among small business concerns that are below the numerical size standard for businesses in that industry . . . [however,] SBA will generally not consider requests from anyone other than a representative of a national trade or industry group.”* OIG was uncertain as to the meaning of *“generally not consider”* in this context. Conceivably, this could lead to charges of special treatment where some entities, but not others, are given different percentages. It could also open the door to SBA being inundated with requests for different treatment. Limiting such requests to national trade or industry groups would ensure that the Agency would be truly considering national interests, as opposed to solely one entity seeking special treatment. HUBZone program officials agreed with our concern and changed the proposed rule to limit any requests to national trade or industry groups.

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Agency Management

Proposed Legislation: S. 1499, and H.R. 3073, each entitled the “American Small Business Emergency Relief and Recovery Act of 2001”

OIG reviewed S. 1499 and H.R. 3073, both entitled the “American Small Business Emergency Relief and Recovery Act of 2001,” which would provide emergency relief to those small business concerns that suffered economic injury as a result of the terrorist attacks on September 11, 2001. OIG supported the proposed legislation, but recommended several clarifications. For instance, the bills provided for disaster loans “to a small business concern that has been directly affected and suffered, or that is *likely to suffer, substantial economic injury* as the result of the terrorist attacks on September 11, 2001.” We found the “*likely to suffer, substantial economic injury*” language to be a very vague standard and recommended that it be further defined, so that SBA could hold applicants accountable to a quantifiable and qualifiable economic injury. The bills also proposed unlimited discretionary authority to the Administrator of SBA to increase or waive otherwise applicable size standards. Potentially, this authority could open the door to disaster loan assistance to a business of any size. This would create a lack of accountability and raise the potential for abuse of the program. We recommended that this provision be changed to provide some established criteria to increase or waive a standard. For example, discretionary authority could be provided to the Administrator to increase or waive the size standard up to 150 percent or 200 percent of the established size standard on a case-by-case basis.

Revision to SOP 00 02, Internal Controls

OIG commented on the Agency’s proposed update to its standard operating procedure (SOP) for internal controls. Among its comments, OIG suggested that the SOP emphasize that all Agency employees are responsible for implementing and adhering to internal controls. OIG also commented that the draft should be changed to reflect General Accounting Office’s (GAO) *Standards of Internal Controls in the Federal Government* as SBA’s primary authority for internal controls --- not the guidance of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). GAO provides the standards of internal control for the Federal Government, whereas COSO’s framework is directed toward the private sector. In addition, GAO standards explicitly reference COSO’s *Internal Control – Integrated Framework* and incorporate appropriate provisions of it. OIG also recommended including SBA’s Chief Information Officer on the list of senior managers that have primary responsibility for establishing and reporting on internal controls. OIG further suggested some language

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that expanded the discussion of responsible monitoring of internal controls. SBA's CFO agreed with our comments and made appropriate changes.

Office of Inspector General

Office of Security Operations

Pursuant to provisions of the Small Business Act and the Small Business Investment Act, SBA requires applicants for assistance to meet certain character standards before participating in Agency programs. OIG's Office of Security Operations (OSO) provides a vital service to help SBA ensure that Agency program participants meet the standards by processing name checks and, where appropriate, fingerprint checks on applicants. To make character eligibility determinations, OSO makes use of its on-line connection with FBI's Machine Readable Data system. When program applicants appear to be ineligible for assistance based on character, OSO makes referrals to program officials for adjudication. During this reporting period, OSO made referrals that resulted in SBA's business loan program managers declining 36 applications and disaster loan program officials declining 18 applications, totaling over \$9.9 million and almost \$3.1 million respectively, for character reasons. Those declinations made available that amount of credit for applicants in whom SBA can have confidence of repayment. In addition, officials of SBA's Section 8(a) and surety bond programs declined, respectively, three applications for certification and one application for guaranty. Almost \$219 million in loans have been declined during the last 10 years due to character eligibility.

OSO also performs background checks to comply with Federal regulations that require Agency employees to have security clearances appropriate for their positions. During this reporting period, OSO initiated 66 background investigations and issued 25 security clearances. OSO also reviewed and adjudicated 70 background investigative reports in accordance with Executive Order 10450 and OMB Circular A-130, and coordinated with SBA's Office of Disaster Assistance to ensure the timely adjudication of 109 derogatory background investigative reports forwarded for review and appropriate action.

OIG Fraud Awareness Briefings

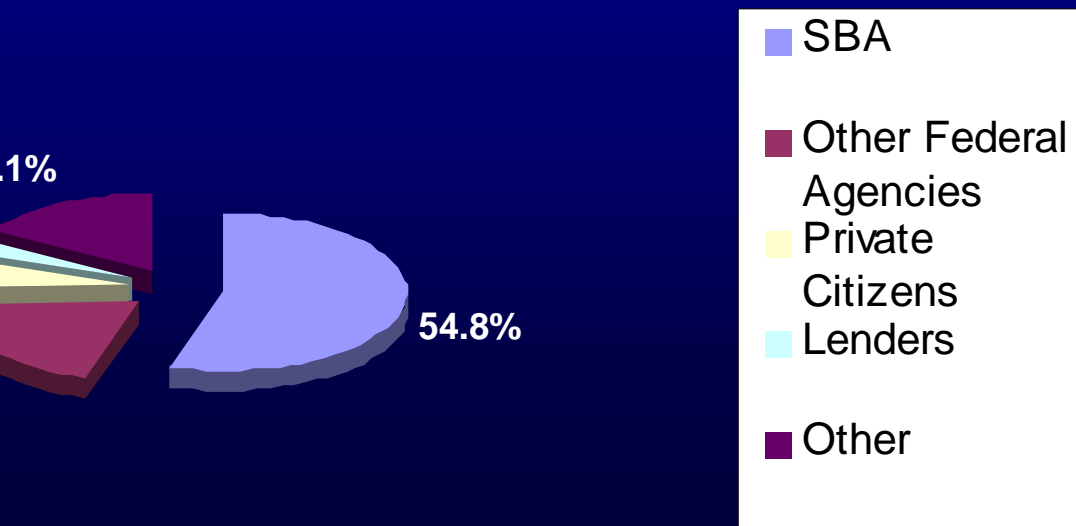
OIG conducted several briefings for SBA's employees, lenders, and other resource partners as part of its mission to educate its customers on identifying waste, fraud, and abuse. During this reporting period (as the chart below indicates) nearly 55 percent of the investigations initiated by OIG originated from within the Agency in the form of referrals either from program heads or other SBA employees. This cooperation indicates the strong commitment of SBA employees to reducing waste, fraud, and abuse

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in Agency programs and improving the Agency's management and control of its programs. The shift in SBA's role from primarily reviewing and processing loans to increasingly providing oversight of lending practices, has caused OIG to change its briefing strategy. Because continued success will depend increasingly on lender referrals, OIG has expanded its integrity-awareness briefing program to include participating lenders and other interested parties. During this reporting period we conducted the following briefings:

- A presentation to 75 attendees at a lenders training session in Seattle, Washington;
- A presentation to 33 attendees at a disaster-fraud awareness training session for State and local law enforcement officers in Oakland, California;
- A presentation to 25 SBA Disaster Loss Verifiers in New York, New York;
- A presentation to 250 SBA Disaster Program employees in Niagara Falls, New York; and
- A presentation to the Affirmative Civil Enforcement Coordinator, U.S. Attorney's Office, District of Maryland.

Sources of Investigations from October 1, 2002, to March 31, 2002



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Direct Investigation Time by Program Area October 1, 2001, to March 31, 2002

Program Area	Direct Time %	Number of Investigations*	
		Closed**	In Progress
Capital Access	75%	35	306
Disaster Assistance	11%	9	121
Government Contracting and Business Development	8%	12	37
Agency Management	6%	12	23
Entrepreneurial Development	***	0	4
Total	100%	68	491

* Includes civil cases

** Includes cases canceled

*** Less than ½ percent

Direct Audit Time by Program Area October 1, 2001, to March 31, 2002

Program Area	Direct Time %	Number of Audits	
		Issued	In Progress
Capital Access	49%	9	7
Disaster Assistance	12%	2	1
Government Contracting and Business Development	2%	0	2
Agency Management	22%	4	8
Entrepreneurial Development	15%	1	3
Total	100%	16	21

OIG Activities

**Direct Counsel Time by Program Area
October 1, 2001, to March 31, 2002**

Program Area	Direct Time %	Number Reviewed*
Capital Access	28%	33
Disaster Assistance	4%	5
Government Contracting and Business Development	15%	17
Agency Management	41%	48
Entrepreneurial Development	3%	3
OIG Community-wide	9%	10
Total	100%	116

* This number reflects proposed legislation, regulations, standard operating procedures, and other issuances, such as policy and procedural notices, Administrator's memos, and other communications that frequently involve the implementation of new programs and policies.

Statistical Highlights

FY 2002 6-Month Productivity Statistics October 1, 2001, through March 31, 2002

Office-wide Dollar Accomplishments	Totals
A. Potential Investigative Recoveries and Fines.....	\$9,391,852.00
B. Loans Not Made as Result of Investigations and Name Checks.....	\$32,090,831.00
C. Disallowed Costs Agreed to by Management	\$88,430.01
D. Recommendations that Funds Be Put to Better Use Agreed to by Management	\$370,629.50
Total	<u>\$41,941,742.51</u>

Efficiency and Effectiveness Activities

A. Reports Issued.....	16
B. Recommendations Issued.....	35
C. Dollar Value of Costs Questioned.....	\$2,837.01
D. Dollar Value of Recommendations that Funds Be Put to Better Use	\$550,848.50

Follow-up Activities

A. Recommendations Closed.....	80
B. Disallowed Costs Agreed to by Management.....	\$88,430.01
C. Dollar Value of Recommendations that Funds Be Put to Better Use Agreed to by Management	\$370,629.50
D. Unresolved Recommendations	40

Legislation/Regulations/SOPs/Other Reviews

A. Legislation Reviewed	7
B. Regulations Reviewed.....	14
C. Standard Operating Procedures Reviewed.....	11
D. Other Issuances Reviewed*	84

* This includes policy notices, procedural notices, Administrator's action memoranda, and other communications, which frequently involve the implementation of new programs and policies.

Statistical Highlights

Fraud Deterrence Activities

A. Total Cases.....	559
B. Closed Cases	68
C. Pending Cases	26
D. Open Cases	465
E. Subjects Currently Under Investigation	1,763
F. Cases Referred to FBI or Other Agencies for Investigation.....	3

Summary of Indictments and Convictions

A. Indictments from OIG Cases	21
B. Convictions from OIG Cases	29

Summary of Recoveries and Management Avoidances

A. Potential Recoveries and Fines as a Result of OIG Investigations.....	\$9,391,852.00
B. Loans/Contracts Not Approved as a Result of OIG Investigations.....	\$19,075,972.00
C. Loans/Contracts Not Approved as a Result of the Name Check Program	<u>\$13,014,859.00</u>
Total:	<u>\$41,482,683.00</u>

SBA Personnel Actions Taken as a Result of Investigations

A. Dismissals	0
B. Resignations/Retirements.....	2
C. Suspensions.....	0
D. Reprimands	0

Program Actions Taken as a Result of Investigations

A. Suspensions.....	3
B. Debarments	0
C. Removals from Program	0
D. Other Program Actions	0

Summary of OIG Fraud Line Operation

A. Total Fraud Line Calls/Letters.....	645
B. Total Calls/Letters Referred to Investigations Division for Evaluation.....	4
C. Total Calls/Letters Referred to Program Offices or Other Federal Investigative Agencies.....	50
D. Total Other Calls/Letters	591

Inspector General Act Statutory Reporting Requirements

The specific reporting requirements prescribed in the Inspector General Act of 1978, as amended by the Inspector General Act Amendments of 1988, are listed below.

Source		Pages
Section 4(a)(2)	Review of Legislation and Regulations	22, 26-27
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	3-31
Section 5(a)(2)	Recommendations with Respect to Significant Problems, Abuses, And Deficiencies	3-31
Section 5(a)(3)	Prior Significant Recommendations Not Yet Implemented	39
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	40-46
Section 5(a)(5) And 6(b)(2)	Summary of Instances Where Information Was Refused	None
Section 5(a)(6)	Listing of Audit Reports	36
Section 5(a)(7)	Summary of Significant Audits	3-24
Section 5(a)(8)	Audit Reports with Questioned Costs	37
Section 5(a)(9)	Audit Reports with Recommendations that Funds Be Put to Better Use	37
Section 5(a)(10)	Summary of Reports Where No Management Decision Was Made	38
Section 5(a)(11)	Significant Revised Management Decisions	None
Section 5(a)(12)	Significant Management Decisions with Which OIG Disagreed	None

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APPENDIX I
Audit and Other OIG Reports Issued
October 1, 2001, to March 31, 2002

TITLE	NUMBER	ISSUE DATE	QUESTIONED COSTS	FUNDS FOR BETTER USE
Capital Access				
Net 1 st Bank	2-01	10/29/01		
Darshan's Paradise Inn	2-03	2/27/02		\$62,401.50
Danbart Corporation	2-05	2/27/02		\$308,228.00
C N A Surety Company	2-06	2/28/02	\$2,837.01	
Safeco/First National Insurance Company	2-07	2/28/02		
SBLC Oversight Process	2-12	3/20/02		
CFM Bracket	2-13	3/21/02		\$116,722.00
Colorado Taco Corporation	2-15	3/29/02		\$63,497.00
Asset Sale Due Diligence Contract	2-16	3/29/02		
Program sub-total	9 reports		\$2,837.01	\$550,848.50
Disaster Assistance				
Disaster Loan	2-10	3/20/02		
Disaster Loan	2-14	3/26/02		
Program sub-total	2 reports			
Entrepreneurial Development				
Women's Business Center	2-11	3/19/02		
Program sub-total	1 report		\$0	\$0
Agency Management				
FY 2002 Top 10 Management Challenges	2-02	1/16/02		
SBA's FY 2001 Financial Statements Audit	2-04	2/27/02		
Agreed Upon Procedures Report on FACTS	2-08	3/4/02		
Agreed Upon Procedures Report on Intra-governmental Activity on Balance Data	2-09	3/4/02		
Program sub-total	3 reports		\$0	\$0
TOTALS (all programs)	16 reports		\$2,837.01	\$550,848.50

APPENDIX II - Part A
Audit Reports with Questioned Costs
October 1, 2001, to March 31, 2002

		REPORTS	RECS*	COSTS**	
				QUESTIONED	UNSUPPORTED
A.	For which no management decision had been made by September 30, 2001	3	4	***\$88,430.01	\$68,699.86
B.	Which were issued during the period	1	1	\$2,837.01	\$0
	Subtotals (A + B)	4	5	\$91,267.02	\$68,699.86
C.	For which a management decision was made during the reporting period	3	4	\$88,430.01	\$68,699.86
	(i) Disallowed costs	2	2	\$88,430.01	\$68,699.86
	(ii) Costs not disallowed	1	1	\$0	\$0
D.	For which no management decision had been made by March 31, 2002	1	1	\$2,837.01	\$0

* Recommendations

** Questioned costs are those which are found to be improper, whereas unsupported costs may be proper but lack documentation.

*** The beginning balance is different than the ending balance of the last SAR because \$485,051 in questioned costs reflected in the last SAR was from a previous reporting period.

APPENDIX II - Part B
Audit Reports with Recommendations that Funds Be Put to Better Use
October 1, 2001, to March 31, 2002

		REPORTS	RECS*	RECOMMENDED FUNDS FOR BETTER USE
A.	For which no management decision had been made by September 30, 2001	0	0	\$0
B.	Which were issued during the period	4	4	\$550,848.50
	Subtotals (A + B)	4	4	\$550,848.50
C.	For which a management decision was made during the reporting period	2	2	\$370,629.50
	(i) Recommendations agreed to by SBA management	2	2	\$370,629.50
	(ii) Recommendations not agreed to by SBA management	0	0	\$0
D.	For which no management decision had been made by March 31, 2002	2	2	\$180,219.00

* Recommendations

APPENDIX II - Part C
Audits Reports with Non-Monetary Recommendations
October 1, 2001, to March 31, 2002

		REPORTS	RECOMMENDATIONS
A.	For which no management decision had been made by September 30, 2001	9	75
B.	Which were issued during the period	6	30
	Subtotals (A + B)	15	105
C.	For which a management decision was made (for at least one recommendation in the report) during the reporting period	10	74
D.	For which no management decision (for at least one recommendation in the report) had been made by March 31, 2002	6	31

APPENDIX II – Part D
Issued Audit Reports with Overdue Management Decisions
March 31, 2002

TITLE	NUMBER	ISSUED	STATUS
PLP Oversight Process	1-19	9/27/01	Negotiating with program officials.

APPENDIX II - Part E
Significant Audit Reports Described in Prior Semiannual Reports
Without Final Action as of March 31, 2002

Report Number	Title	Date Issued	Date of Management Decision	Final Action Target
43H006021	8(a) Continuing Eligibility	9/30/94	***	3/31/02
87H002017	NOAA Computer Contracts	6/18/98	11/19/01	3/31/02
9-15	Disaster Home Loan Servicing Centers	8/3/99	***	5/31/02
9-23	Survey of Electronic Records Management	9/15/99	11/30/99	8/31/02
0-14	7(a) Service Fee Collection	3/30/00	8/22/00	10/31/02
0-15	SBA's Proposed Systems Development Methodology	3/30/00	9/29/00	9/20/02
0-19	SDB Certification Program Obligations & Expenditures	6/30/00	***	3/31/02
0-25	GPRA - SBIC Program	9/7/00	***	**
0-26	GPRA - Surety Bond Guarantee Program	9/25/00	***	7/31/02
0-28	Rhode Island District Advisory Council	9/29/00	***	5/31/02
0-29	MBELDEF Cosponsorship	9/30/00	***	**
0-30	SBA Administration of MBELDEF	9/30/00	***	**
0-31	Boscart Construction, Inc.	9/30/00	***	**
1-01	GPRA - 7(a) Business Loan Program	12/4/00	***	9/30/02
1-06	GPRA - Disaster Assistance Program	2/15/01	***	7/31/02
1-09	SBA's Planning and Assessment for Implementing PDD 63	3/26/01	9/27/01	10/30/02
1-11	GPRA - MSB/COD Program	3/27/01	9/28/01	9/30/02
1-12	SBA's Information Systems Controls - FY2000	3/27/01	***	**
1-14	Paper Report Production	8/3/01	12/21/01	**
1-15	FY 2000 Financial Statements - Management Letter	8/15/01	***	**
1-16	SBA's Follow-up On SBLC Examinations	8/17/01	9/25/01	6/30/02
1-17	Vermont Women's Business Center	9/19/01	***	**
1-18	Farmington Casualty Company	9/21/01	11/8/01	4/12/02
A1-05	SBA's Use of Government Cars and Hired Car Services	9/27/01	1/15/02	4/30/02
1-20	Agreed-upon Procedures Report on Sensitive Payments	9/28/01	12/18/01	4/30/02
1-21	SBA's UNIX Operating Systems	9/28/01	***	**
A1-06	Evaluation of SBA's Computer Security Program	9/28/01	***	**
2-03	SBA Loan to Darshan's Paradise Inn	2/27/02	3/21/02	4/27/02
2-05	SBA Loan to Danbart Corp	2/27/02	3/21/02	5/31/02

* At least one recommendation remains open. ** Target dates vary with different recommendations.

*** Management decision dates vary with different recommendations.

APPENDIX III
Six Month Arrested/Indicted/Convicted Summary

State	Program	Alleged Violation(s) Prosecuted	Arrested/ Indicted/ Convicted/	Investigated Jointly With. . .
AL	SBG	Construction executive fraudulently influenced SBA to guarantee five surety bonds totaling \$1.17 million. On SBA application, he denied having criminal history; in fact, he had been charged with, arrested for, and/or convicted of 29 criminal offenses. He also reported ownership of two pieces of real estate with total value of \$450,000. He did not own these properties, and their combined actual value was less than \$50,000. His company failed to complete any of bonded contracts, and SBA preferred surety insurance company paid \$324,170 on these bonds. *	Executive convicted	None
AZ	BL	In connection with \$1 million SBA-guaranteed loan to buy two fast-food restaurants, friend helped create fraudulent promissory note for bogus \$400,000 loan from him to indicate that two SBA borrowers had greater debts, requiring larger loan. Prior to loan closing, additional fraudulent documentation was created to show that note had been paid down to about \$206,000 and that remaining debt could be paid with \$150,000 in SBA-guaranteed loan proceeds and about \$56,000 in personal funds. Friend never received \$56,000 but, at loan closing, \$150,000 check was issued from SBA loan proceeds as his payoff on fraudulent note. He in turn endorsed check to one borrower and never received any benefit for his role in fraudulent note. Defendants used \$150,000 for personal and business benefit.	Borrowers pled guilty	FBI
AZ	BL	Business brokers submitted fraudulent documents to private lenders to obtain 100-percent financing for clients seeking business acquisition loans guaranteed by SBA; inflated purchase price to cover actual selling price plus cash injection; arranged for buyer to obtain real estate license and listed as asset commission that borrower would earn for sale of business; arranged for third party injectors to loan required down payment as cash injection; and received inflated commission and arranged for portion of commission that was loaned by third party injectors (plus fee) to be wired back to third party. *	Brokers pled guilty	FBI
CA	BL	To obtain \$90,000 LowDoc loan, businessman submitted fraudulent documents, including invoice for leasehold improvements by non-existent construction company; actually, borrower's cousin (not licensed contractor) had made some improvements worth far less.	Businessman indicted	None
CA	BL	Produce business owner who had received \$225,000 SBA-guaranteed loan was arrested on felony warrant that had not been disclosed in loan application. *	Businessman arrested	Local law enforcement agencies

State	Program	Alleged Violation(s) Prosecuted	Arrested/ Indicted/ Convicted/	Investigated Jointly With...
CO	BL	To obtain \$100,000 LowDoc loan, painting company owner failed to disclose \$250,000 in business debts and two pending lawsuits; used some loan proceeds for personal purchases instead of authorized business debts; and failed to list numerous assets during bankruptcy.	Businesswoman pled guilty	FBI
CT	BL	About 3 weeks after obtaining \$450,000 SBA-guaranteed bank loan, printing company owner filed for personal bankruptcy, concealing his ownership of borrower and two other companies; also concealed his personal guaranty of loan and his personal assets.	Businessman indicted	None
IL	BL	To obtain \$1.25 million SBA-guaranteed loan, restaurateur and three attorneys conspired to inflate purchase price by \$180,000; falsified \$398,938 capital injection; and created bogus \$215,000 second mortgage. Two attorneys conspired to obstruct justice by fabricating notes in response to grand jury subpoenas. In his loan application, restaurateur lied regarding his citizenship and criminal history. *	Restaurateur, corporation and three attorneys indicted	FBI
IL	BL	To obtain \$400,000 SBA-guaranteed loan, president of contracting business signed affidavit that she and company were current on all taxes, when they actually owed more than \$1 million.	Businesswoman charged	FBI
KY	BL	Conspiring to fraudulently obtain \$250,000 in SBA-guaranteed loans, president of roadside construction company, his brother, and guarantor submitted falsified invoices for machinery, equipment, and furniture, then falsely negotiated joint-payee loan checks and allowed company vehicle to be titled in brother's name and sold. *	Businessman, brother, and guarantor indicted; businessman and brother pled guilty	None
MO	BL	To obtain \$340,000 SBA-guaranteed loan, boat-propeller manufacturer's president failed to disclose numerous personal and corporate liabilities; subsequently submitted other fraudulent documents; bilked investors in another of his corporations; and laundered funds.	Businessman indicted	IRS, state attorney general
NJ	BL	To obtain \$500,000 SBA-guaranteed loan, plating/finishing company and three principal officers failed to purchase machinery and fixtures as required in loan agreement, provided forged landlord waiver, and passed three forged checks to. Same four defendants plus second plating/finishing company and its owner committed environmental crimes.	Four individuals and existing corporation pled guilty; charges against defunct corporation dismissed	EPA/OIG, state enforcement agency
NJ	BL	One of defendants from case above, also chief financial officer of now-defunct electronic imaging company, schemed to illegally divert funds from \$1 million SBA-guaranteed loan.	CFO charged and pled guilty	EPA/OIG, state enforcement agency

State	Program	Alleged Violation(s) Prosecuted	Arrested/ Indicted/ Convicted/	Investigated Jointly With. . .
NM	DL	Using name and SSN of deceased acquaintance, woman obtained post-disaster assistance, including \$40,000 SBA home loan; submitted numerous false documents; also attempted to obtain information about claim and investigation by posing as representative of U.S. Attorney's Office. Neither she nor deceased acquaintance ever resided at address claimed in disaster-assistance application. Subsequently charged with additional counts of mail fraud, wire fraud, and impersonation. *	Woman convicted	FEMA/OIG
NY	SBIC	Village official conspired to misappropriate SBA funds through specialized SBIC, to which SBA had provided \$1.2 million of leverage funding, by making and concealing of improper loans. *	Village official (former SBIC board member) pled guilty	ED/OIG, HUD/OIG, IRS
NY	DL	Caretaker for mentally ill assisted elderly woman including managing her disaster loan application submission when hurricane damaged her home. He was arrested on charge of submitting altered invoices for work purportedly performed on her home; some were actually for work on properties he owned. His alleged false statements led to \$78,300 being loaned to elderly woman. He personally used much of loan proceeds to pay for repairs at his residences and to pay down debts. *	Caretaker indicted and pled guilty	FBI
PA	8aBD	To maintain certification in Section 8(a) program, construction company president represented that he had relocated from Michigan with, and continued to control, his firm. Actually, he never relocated but had friend (who was ineligible for Section 8(a)) run firm. *	President indicted	DCIS, NCIS, USCS, VA/OIG
PA	BL	President of Civil-War clothing company submitted false Federal tax returns in unsuccessful effort to obtain \$243,000 SBA-guaranteed loan. *	President indicted	None
TX	BL	President of brake parts company created fraudulent invoices showing inventory of business as being sold when, in fact, merchandise was still in his possession. He then filed for both personal and corporate bankruptcy while using company's inventory to start second company. He and his wife executed scheme by "check-kiting" assets through numerous accounts. SBA loans obtained by them totaled \$500,000.	President pled guilty	FBI
TX	BL	To obtain \$105,340 in SBA-guaranteed loan proceeds, construction company president presented to bank documents falsely representing his company had purchased \$131,675 of equipment from rental company.	President charged and pled guilty	FBI
TX	BL	To obtain \$77,500 SBA-guaranteed loan, co-owner of dry cleaning business submitted falsified personal financial statement; subsequently falsely certified to no substantial adverse change in financial condition.	Co-owner indicted	FBI, PIS

State	Program	Alleged Violation(s) Prosecuted	Arrested/ Indicted/ Convicted/	Investigated Jointly With. . .
WA	BL	To obtain draws on various lines of credit, including \$1.3 million line guaranteed by SBA, former owner of evergreen import/export companies submitted false documents to bank; diverted payments away from participating lender; diverted proceeds for unauthorized personal use; and defrauded European taxing agencies.	Former owner indicted and arrested	FBI, foreign government

* This case is further discussed in the narrative section of this report.

Program codes: BL=business loans, DL=disaster loans, 8aBD=Section 8(a) business development, SBG=surety bond guaranties, SBIC=small business investment companies

Joint-investigation Federal agency acronyms: DCIS=Defense Criminal Investigative Service; ED/OIG=Education Department OIG; EPA/OIG=Environmental Protection Agency OIG; FBI=Federal Bureau of Investigation; FEMA/OIG=Federal Emergency Management Agency OIG; HUD/OIG=Housing & Urban Development Department OIG; IRS=Internal Revenue Service; NCIS=Naval Criminal Investigative Service; PIS=Postal Inspection Service; USCS=Customs Service; VA/OIG=Veterans Affairs Department OIG

APPENDIX IV
Six Month Sentencing Summary

State	Program	Alleged Violation(s) Prosecuted	Confinement Time and Dollar Results (Criminal Restitution/Fines/Etc.)	Investigated Jointly With. . .
CA	DL	Couple obtained \$231,300 disaster home loan following Northridge earthquake by submitting false invoices; received repayment deferments by concealing ownership of real estate properties. *	Husband: 18 months in prison Wife: 5 months incarceration + 5 months home confinement Both defendants jointly: \$203,500 restitution	None
CA	BL	Tax preparer was responsible for altered "copies" of tax returns submitted on behalf of clients who consequently received SBA-guaranteed loans. *	8 months in prison, \$2,000 fine + \$600,000 in back taxes to IRS	FBI, IRS
CT	BL	To obtain \$100,000 SBA-guaranteed loan, former co-owner of dry cleaning business falsified capital injection; pledged as collateral equipment just pledged to another lender. *	Charged and pled guilty, \$100,000 restitution	None
DC	IC	Former owner of SBIC misspent funds of SBIC for unauthorized and personal uses. *	Signed agreement to pay \$490,000 against civil judgment, paid first \$50,000	None
IA	BL	To obtain \$1.4 million SBA-guaranteed loan to purchase business, former president of meat company wrote insufficient-funds check and perpetrated "check kite" to make it appear that required equity injection was made; concealed undisclosed promissory note to seller; converted vehicles pledged to bank on same loan. Subsequently charged with unreported international transportation of currency, embezzlement of \$483,486, money laundering. *	63 months in prison, \$1,232,000 restitution + \$468,934 forfeiture	FBI, USCS, PWBA
KY	8aBD	Former Ohio Section 8(a) contractor participated in fraudulent conspiracy to circumvent program graduation rules, using his sons to establish Section 8(a) companies in other States to surreptitiously maintain his participation in program. Other conspirators were his wife, nephew, and former vice president. *	6 months home confinement, fines totaling \$2,963,197 Charges against other five defendants dismissed	EPA/OIG, DCIS

State	Program	Alleged Violation(s) Prosecuted	Confinement Time and Dollar Results (Criminal Restitution/Fines/Etc.)	Investigated Jointly With. . .
MO	8aBD	President of Section 8(a) construction company used intimidation or threats against two company employees to obtain part of their compensation during Government construction project; used U.S. mail to obtain money from insurance companies by false pretenses; submitted false statements to SBA to obtain Section 8(a) status and resulting contracts, falsely claiming to be Cherokee and to have suffered consequent economic disadvantage. Section 8(a) application also concealed his criminal record for assault. Company received \$1 million in Federal contracts due to president's fraudulent representations. *	President and corporation both pled guilty, both suspended from executive-branch contracting and non-procurement assistance, corporation suspended from Section 8(a), \$3.75 million in already-approved 8(a) contracts cancelled, and \$4.9 million in pending 8(a) contracts denied	FBI, DOL/OIG
NV	DL	To obtain \$213,600 disaster home loan, man claimed he was employed 10 months and earned \$60,000; actually, he was employed for 3 months and earned only \$2,060.	\$25,904 restitution	State attorney general
NH	BL	Former executive director of nonprofit microlender greatly overstated, in reports to SBA, actual balances of microloan accounts; converted to his personal use \$13,042 in microloan funds. *	Pled guilty, \$28,336 restitution	None
NY	SBIC	Former president of SBIC charged with: Improperly negotiating for his personal use \$84,400 in checks drawn on SBIC's bank account; causing illegal transfer of parcel of real estate valued at \$363,613 from SBIC without consideration to second company he solely owned; causing illegal transfer of property valued at \$361,296 from SBIC without consideration to third company he owned; improperly causing \$33,869 in loan payments from borrower to be diverted from SBIC to his solely owned company and later converted to his own use; and illegally causing \$119,096 in loan payments from another borrower to be diverted to his solely owned company and converted to his own use. His actions forced SBA to liquidate SBIC. *	2 months incarceration, 6 months home confinement, \$953,274 restitution	None
OH	BL	Pet store president obtained \$100,000 LowDoc loan. During application process, he concealed about \$200,000 in debt and information regarding his criminal history. Prior to applying for SBA loan, he had been arrested on multiple offenses, charged with various crimes, and convicted of felony of carrying concealed weapon. *	Convicted, 14 months in prison, \$83,203 restitution	None
OH	BL	Four individuals formed conspiracy to defraud Government, devised by licensed real estate agent/business broker to facilitate \$325,000 SBA-guaranteed loan for purchase of forklift sales/repair business; fraudulently provided funds for required capital injection prior to loan closing; inflated contract sales price; concealed transfer of funds between defendants. Buyer concealed his substantial criminal history. *	Broker: 2 years in prison, \$46,500 restitution	None

State	Program	Alleged Violation(s) Prosecuted	Confinement Time and Dollar Results (Criminal Restitution/Fines/Etc.)	Investigated Jointly With. . .
PA	BL	President of defunct ship repair business that had \$7.5 million revolving line of credit and \$650,000 SBA-guaranteed loan transferred proceeds to his Guam shipbuilding company before filing bankruptcy. *	Paid participating lender \$1,985,000 settlement, of which \$80,000 applied to SBA-guaranteed loan	DCIS, FBI, NCIS, PWBA
TX	BL	To obtain \$156,000 SBA-guaranteed loan, owner of auto service center submitted 3 years of falsified tax returns and IRS tax return verifications, along with fraudulent documentation of required capital injections and equipment purchases. Loan proceeds were used for personal expenditures. *	2 years in prison	TIGTA
TX	BL	Sixteen defaulted SBA-guaranteed loans were identified as part of alleged fraudulent scheme.	Participating lender agreed to release SBA from guaranty liability of more than \$8.2 million.	FBI
TX	BL	Having been indicted on 26 felony counts of fraud in connection with two fraudulent loans (totaling \$555,000), defendant engaged two individuals to apply for \$1 million SBA-guaranteed loan for sham sale of his business. OIG notified lender of status of "seller."	\$1 million savings from declined loan	TIGTA
VA	BL	Chiropractor submitted false equipment invoices and false building lease in support of his application for SBA-guaranteed loan of \$337,000 to purchase equipment. Upon receiving two-payee disbursement checks for loan, he forged endorsement of equipment company and deposited checks into his personal account. He subsequently defaulted on \$136,617 loan balance. *	6 months home confinement, \$136,617 restitution	FBI

* This case is further discussed in the narrative section of this report.

Program codes: BL=business loans, DL=disaster loans, 8aBD=Section 8(a) business development, SBIC=small business investment companies

Joint-investigation Federal agency acronyms: DCIS=Defense Criminal Investigative Service; DOL/OIG=Labor Department OIG; EPA/OIG=Environmental Protection Agency OIG; FBI=Federal Bureau of Investigation; IRS=Internal Revenue Service; NCIS=Naval Criminal Investigative Service; PWBA=Pension & Welfare Benefits Administration; TIGTA=Treasury Department Tax Administration OIG; USCS=Customs Service

MAKE A DIFFERENCE

To promote integrity, economy, and efficiency, we encourage you to report instances of fraud, waste, or mismanagement to the SBA OIG FRAUD LINE.*

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